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TREASURY FOR INTERNATIONAL AFFAIRS - CPLANTIER

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SUBJECT: Reports of Turkish Clash with IMF Overstated

Ref: A) Ankara 1528; B) Ankara 1629

1.(SBU) Summary: After months in hibernation, social security reform legislation was finally approved by a parliamentary commission with a new round of predictions it will be passed into law in April. The IMF has long planned to send an overdue mission to Turkey once this crucial legislation is enacted, and will probably still do so, despite Government backsliding on tax policy. Though the backsliding poses a dilemma for the IMF, the GOT has signaled a pullback from confrontation. End Summary.

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Social Security Reform Comes Back to Life  
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12. (SBU) After months in hibernation in a sub-commission of the Plan and Budget Commission, the full Plan and Budget Commission finally approved the social security pension reform legislation that would gradually reduce the massive deficits in Turkey's state pension system. On March 30, the commission finished approving the legislation, opening the way to consideration by the full parliament. Both the IMF Deputy Resrep and a World Bank economist told us they would have to scrutinize the approved version to make sure Parliament didn't undermine the changes in contribution and payout formulas that create the cost savings.

13. (SBU) The Government has been trying to pass the reform since last spring, and it is by far the single most important structural reform in the IMF program. The GOT twice (June and October) tried to pass the legislation, only to pull back in the face of a fierce filibuster by the opposition Republican People's Party (CHP). In December, the IMF postponed its requirement that the law be passed and approved the first and second reviews. Since then, the IMF has been clear it would not send a mission to consider the third review (now overdue) until the legislation was passed. Passage is now likely in April, a prediction Labor Minister Basesioglu made publicly on March 30. Strangely, neither the press nor the AK Party parliamentarian we spoke to have explained what happened to the opposition filibuster this time. The parliamentarian merely said: "they are trying." Whatever the explanation, the Government's strategy of slowly and quietly moving the bill through the commission seems to have worked.

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Just how bad IS the fiscal backsliding?  
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14. (SBU) The VAT rate cut for the textile industry and additional payment to civil servants (reftels) and consideration of other program-contravening fiscal measures led to a wave of speculation in both Turkish and international press of a looming clash with the IMF. The IMF Managing Director's unprecedented public criticism added to this impression. IMF staff tell us they are disappointed with the lack of consultation and saddened at the one-off policy measures that undermine the overall strategy of not cutting tax rates until the tax base has broadened. On the other hand, the tone of their criticism does not suggest an imminent rupture. Should the GOT pass the social security legislation, the Deputy Resrep personally believes the Fund will send a mission to assess the situation. A mission will probably result in some sort of compromise solution with compensating measures that will enable the program to continue.

15. (SBU) Our sense that IMF-Turkish relations while bad, are not yet at a crisis, was reinforced by two different contacts telling us that the disagreement over the additional civil service payment is all a misunderstanding. A Finance Ministry budget official who is also a PhD economist educated in the U.S., insisted the additional payment was fully incorporated in the 2006 budget, echoing Deputy Prime Minister Sener's earlier public comments. Likewise, the World Bank economist, perplexed by the IMF's criticism, agreed the budget covered the payments. IMF officials had told us a portion of it (0.1% of GDP) was not budgeted for, but said they were studying the issue. A separate technical team is in Ankara to look at this, among other budgetary issues.

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Unakitan and Sener Backtrack  
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16. (SBU) Adding to concerns about fiscal backsliding was Finance Minister Unakitan's March 27 response to a reporter's question about the tourism sector's pleas for a textile-like VAT rate cut. His answer -- that the Government was considering the issue -- was widely interpreted to mean the Government planned to cut tourism sector taxes, which would be yet another contravention of the IMF agreement. On March 29, Unakitan backtracked, saying, "Just because we cut taxes in the textile sector we are not going to cut taxes in all sectors."

17. (SBU) In a similar vein, Deputy Prime Minister Sener announced on March 30, that the Government would not consider additional tax cuts until the 2007 budget, which would be negotiated with the IMF. The Unakitan and Sener comments, taken together, represent a clear signal the government did not want to exacerbate problems with the IMF.

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We've Seen This Play Before  
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18. (SBU) The GOT's contravention of its IMF commitment, followed by a pullback from outright confrontation, follows a familiar script. As in past years, the GOT pretends it doesn't have a specific IMF commitment in order to pander to popular opinion, then patches things back up with the IMF. Having waived the social security reform condition in December, the IMF has to be firm about parliamentary passage of that particular reform, but is unlikely to want to take too hard a line in other areas. With Argentina and Brazil having repaid, not only is Turkey its major success story, but Turkey accounts for 72% of the IMF's credit outstanding. As J. Paul Getty's famously said, "If you owe the bank \$100 that's your problem. If you owe the bank \$100 million, that's the bank's problem."

